



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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May 12, 2000

The Honorable Mitch McConnell
361-A Russell Senate Office Building
Washington, DC 20510-1702

Attention: [REDACTED]

Dear Senator McConnell:

This letter is in response to your inquiry [REDACTED] on behalf of your constituent, [REDACTED]. [REDACTED] writes about the nonfarm optional method for calculating self-employment taxes, which allows an individual to report \$1600 of earnings for the year.

[REDACTED] states that an individual must earn \$780 for each quarter of coverage for social security benefit purposes. He notes that, for the year 2000, a taxpayer utilizing the nonfarm optional method and reporting \$1600 will earn only two quarters of coverage. [REDACTED] asks about the purpose of the nonfarm optional method and the significance of the \$1600 amount. I am providing you with the following general information in response to [REDACTED] questions.

First Question: What is the purpose of allowing a taxpayer to use the nonfarm optional method of calculating self-employment taxes?

In general, a self-employed person pays social security tax on and receives social security credit for the actual amount of his net earnings. As explained in Internal Revenue Service Publication 533, *Self-Employment Tax*, the nonfarm optional method permits a taxpayer whose net profit for the year is small, or who has a loss, to continue paying social security tax and thus to receive social security coverage. Under the Internal Revenue Code (the Code), a taxpayer using this optional method may report \$1600 of net earnings for the year and that amount will be credited to his earnings record for social security purposes. No provision of the Code requires that reported earnings under the optional method correspond with the amount necessary to earn four quarters of coverage for social security benefit purposes.

Second question: What is the significance of the \$1600 amount that is used?

We reviewed the legislative history of the optional method and cannot find any explanation of how the \$1600 amount was determined.

How an individual earns credits for social security benefit purposes is within the jurisdiction of the Social Security Administration. However, enclosed is some material taken from the Social Security Administration's website relating to how an individual earns credit for social security benefits and the application of the optional method for self-employed individuals.

This letter will be available for public inspection after names, addresses and other identifying information has been deleted, as appropriate, under the Freedom of Information Act.

I hope this information will be helpful. If we can be of further assistance in this matter, please contact me at (202) 622-6010 or Dan Boeskin (ID # 50-16785) at (202) 622-6040.

Sincerely,

Mary Oppenheimer
Assistant Chief Counsel
(Tax-Exempt and Governmental Entities)

Enclosures (2)